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## EU-25

## Dairy and Products

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**Report Highlights:**

Cheese consumption was the driving force in the 2004 EU dairy market and is expected to continue into 2005. The resulting increase in cheese production is expected to absorb all the extra milk supplies as milk deliveries recover from the 2004 low. As a result, WMP and NFDM production are forecast to remain below market potential, which is expected to maintain firm market pricing until Oceania returns to the market with new supplies.

Deficiencies in NFDM supplies in 2004 were covered by sales from EU intervention stocks but that is forecast to end during 2005 when stocks run empty. The EU butter market is benefiting from this situation as well, although not to the same extent.

The integration of New Member States into the EU dairy market upon accession led to stronger dynamics in intra EU trade. However, disruption of the dairy market, as some had feared, didn't occur, while farm incomes in most NMS benefited from increased milk prices.

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## Table of Contents

<b>Executive Summary</b>	<b>4</b>
<b>Fluid Milk</b>	<b>5</b>
<b>Cheese</b>	<b>6</b>
<b>Butter</b>	<b>7</b>
<b>Whole Milk Powder (WMP)</b>	<b>8</b>
<b>Non Fat Dried Milk (NFDM)</b>	<b>9</b>
<b>Consequences of the CAP reform and possible implications from the Doha Development Agenda</b>	<b>10</b>
<i>Milk production prospects</i>	<i>10</i>
<i>Other possible developments resulting from CAP reform and the DOHA round negotiations</i>	<i>10</i>

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Following the accession of ten New Member States (NMS)<sup>1</sup> to the European Union on May 1, 2004, dairy statistics for recent years have become more readily available. While still a challenge for some member states (MS), this has allowed us to build all 25 MS PSD's for dairy products, adding up to more reliable EU-25 consolidated PSD's for 2003. At the same time, we have taken this opportunity to further harmonize definitions and methods between all MS. Together with 2004 production and trade data now complete, if yet not final, this has led to some significant changes in data compared to the previous set from the 2004 annual report (GAIN E34083). For these reasons, a comparison between these two sets of PSD's needs caution because changes are not necessarily attributable to changes in the market.

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<sup>1</sup> Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia

## Executive Summary

With NMS accession having occurred a year ago now, it is probably proper to state that the transition and integration in the EU went well beyond expectation. The disruption of EU markets, including dairy markets, which many pessimists were expecting, didn't occur. On the contrary, agricultural income in most, but not all, NMS increased spectacularly by the end of 2004. Dairy markets in the EU-15 did get a significant boost as well, with trade between EU-15 and NMS jumpstarting upon accession. The increased dynamism in the enlarged EU dairy market was initially driven by the large price differences between the EU-15 and some of the NMS. While this price differential is fading rapidly, it will still take years for NMS dairy industries to adjust to the new market situation, as well as the increase in NMS household incomes will offer good market opportunities for EU-15 added-value dairy products. Dairy producers and industry in the EU-15 are also facing important changes as the 2003 CAP reform gets fully implemented in 2005 and beyond.

Four main developments developed in the past year 2004 and are believed to drive EU dairy markets in 2005. The first is the recovery of milk production in 2005, after a decrease in 2004, which was a delayed consequence of the 2003 drought in several MS. Milk production is also expected to increase further in the coming years when the agreed increases in milk production quota are implemented. The second is the long-term increase in cheese consumption, which turned out to be particularly vigorous in 2004 with a 4 percent increase, despite the decrease in milk supplies. This increase in cheese consumption is expected to continue in the coming years, with larger increases in consumption forecast in the NMS than in the EU-15. The third one, a decrease in production of milk powders, both WMP and NFDM, is a consequence of the large increase in cheese production. These decreases occur despite a sustained demand and high world market prices as a result of lack of milk supplies. This explains why dairy prices in the EU market haven't decreased as anticipated in reaction to the decrease in intervention price for NFDM and butter. This deficit in NFDM production was filled by sales of NFDM out of intervention stocks. This mechanism is forecast to end in 2005 as NFDM stocks are expected to be exhausted. The fourth development is in the butter market, for which the increase in cheese production plays the same role as for the milk powder markets. However, reported changes in consumer purchasing patterns could undermine our forecast about the decrease in butter stocks at the end of 2005.

With the accession of Bulgaria and Romania scheduled at the beginning of 2007, the EU dairy cow herd will further increase by about half the size of the NMS herd. The accession of these countries with about 30 million more consumers are expected to create another wave of adjustments in the EU dairy market, with similar opportunities as with the 2004 enlargement.

## Fluid Milk

<b>Country:</b>	<b>EU-25</b>					
<b>Commodity:</b>	<b>Dairy, Milk Fluid</b> ('000 Heads; '000 MT)					
	<b>2003</b>		<b>2004</b>		<b>2005</b>	
	Old	New	Old	New	Old	New
<b>Calendar Year Begin</b>	<b>01/2003</b>		<b>01/2004</b>		<b>01/2005</b>	
Cows In Milk	24,690	24,456	24,285	23,963	23,907	23,382
Cows Milk Deliveries to Dairies	132,044	131,847	131,119	130,825	132,072	131,700
Other Milk Production	2,732	4,160	2,818	4,230	2,916	4,300
Total Milk Production	134,776	136,007	133,937	135,055	134,988	136,000
Extra EU25 Imports	13	6	3	2	5	3
<b>TOTAL SUPPLY</b>	<b>134,789</b>	<b>136,013</b>	<b>133,940</b>	<b>135,057</b>	<b>134,993</b>	<b>136,003</b>
Extra EU25 Exports	124	194	128	167	110	150
Fluid Use Dom. Consum.	34,217	34,633	33,998	34,237	34,141	34,403
Factory Use Consum.	100,448	101,186	99,814	100,653	100,742	101,450
Feed Use Dom. Consum.	0	0	0	0	0	0
Total Dom. Consumption	134,665	135,819	133,812	134,890	134,883	135,853
<b>TOTAL DISTRIBUTION</b>	<b>134,789</b>	<b>136,013</b>	<b>133,940</b>	<b>135,057</b>	<b>134,993</b>	<b>136,003</b>

Sources: FAS offices in EU MS, Eurostat, Global Trade Atlas

For **2005**, EU-25 milk deliveries to dairies are forecast to recover by 0.7 percent to just below the 2003 production level, after 2004 milk production had dipped in some MS as a delayed consequence of the 2003 drought. This increase is expected despite the long-term trend decline in the dairy herd. Other reasons for the increase are the ongoing switch from on farm use to deliveries to dairies in the NMS. Especially in Poland, temporarily, large volumes of milk are still sold off the farm, which do not appear in the milk delivery and consumption statistics. Milk production is also increasing in those MS which already obtained increases in their milk production quota of about 1.4 million ton in the past years: Italy (600.000 MT), Spain (550.000 MT), Ireland (150.000 MT), Greece (70.000 MT) and United Kingdom – Northern Ireland (19.700 MT). Several NMS, including Poland, the Czech Republic and the Baltic states, are also lobbying to increase production quota, by activating quota reserves, but they need EC approval. On the other hand, Hungary, Slovakia and Slovenia are struggling to fill their production quota as profitability of dairy production fell after accession, as a result of the abolishment of generous government subsidies. In the EU-15, Denmark and Spain are already working to make rules to trade production quota between farmers in different areas more flexible, while other MS are more hesitant to go this way. Non-cow milk deliveries are still increasing as these are not bound by production quota and because good market opportunities exist for cheeses derived from this milk.

Extra-EU milk exports are expected to further decline, as NMS started exporting milk to the EU-15 after accession. Also, a German dairy reportedly contracted for the purchase of 75 thousand MT from Czech milk producers for 2005. Domestic consumption of fluid milk is continuing its long-term decline, but is forecast to recover somewhat from the 2004 depression, which was caused by the poor summer weather. Consumption habits are changing as EU consumers continue to replace full fat milk with semi-skimmed milk, as well as switching to flavored milks.

In **2004**, milk production was reduced as a result of the 2003 drought in Austria, Spain, France and the UK; and because of fears for superlevies for overshooting milk production

quota in the Benelux, Denmark, Germany and Italy. Nevertheless milk quota was slightly overshot in Austria (1.3%), Belgium, Denmark, Germany (1.3%) and Italy. France, Spain and the United Kingdom failed to fill their quota.

## Cheese

<b>Country:</b>	<b>EU-25</b>					
<b>Commodity:</b>	<b>Dairy, Cheese ('000 MT)</b>					
	<b>2003</b>		<b>2004</b>		<b>2005</b>	
	Old	New	Old	New	Old	New
<b>Calendar Year Begin</b>	<b>01/2003</b>		<b>01/2004</b>		<b>01/2005</b>	
Beginning Stocks*	126	0	115	0	123	0
Production	6,117	6,100	6,292	6,345	6,364	6,420
Extra EU25 Imports	119	127	118	102	118	105
<b>TOTAL SUPPLY</b>	<b>6,362</b>	<b>6,227</b>	<b>6,525</b>	<b>6,447</b>	<b>6,605</b>	<b>6,525</b>
Extra EU25 Exports	553	514	583	500	586	525
Domestic Consumption	5,421	5,713	5,551	5,947	5,633	6,000
Other Use, Losses*	273	0	268	0	263	0
TOTAL Dom. Consumption	5,694	5,713	5,819	5,947	5,896	6,000
Ending Stocks*	115	0	123	0	123	0
<b>TOTAL DISTRIBUTION</b>	<b>6,362</b>	<b>6,227</b>	<b>6,525</b>	<b>6,447</b>	<b>6,605</b>	<b>6,525</b>

\* The elimination of cheese stocks and "Other uses, losses" was the result of a stricter interpretation of the definitions for these categories in the reporting instructions.

Sources: FAS offices in EU MS, Eurostat, Global Trade Atlas

In **2005**, cheese production is forecast to further increase by more than one percent, half of it in Germany and the remainder in Denmark, Poland and Spain. As cheese production offers the highest profits to the industry, it is expected to use most of the extra milk output to meet the increase in domestic cheese demand. This is enhanced as profitability of NFDM and butter production is falling as a result of the decreases in intervention prices for these products. Cheese consumption in the EU-25 is forecast to increase by 1 percent; with an increase of 2 percent in the NMS, compared to only about 0.5 percent in the EU-15 overall. At the same time, sustained demand in export markets is forecast to spur recovery of cheese exports in 2005 beyond the 2003 level, while imports, mainly from Switzerland and Oceania, are expected to remain stable. Exports to the United States and Japan are expected to continue to increase, while exports to Russia are forecast to remain at a lower level, until new, post accession export approvals for NMS dairies are signed by the Russian veterinary authorities.

The increases forecast for 2005 are rather modest compared to the surges in cheese production and consumption, which were recorded in **2004**. Despite the serious drop in milk deliveries, cheese production and consumption soared by 4 percent, compared to 2003. The largest increases in cheese production were recorded in Italy, Germany, France and the Benelux. Some decreases in cheese production were recorded in Finland, Slovakia and Sweden. The increase in domestic cheese consumption led to a lack of cheese supplies to sustain cheese exports at the 2003 level. Surprisingly, cheese imports in 2004 decreased by 20 percent; however, only from New Zealand, as its exports shifted more to Asian markets. Trade statistics also show a marked shift upon accession in cheese exports from Poland and Lithuania from third countries towards the EU-15; however, part of these exports were

transshipments through Western European ports. Imports from the EU-15 increased significantly in most NMS.

## Butter

<b>Country:</b>	<b>EU-25</b>					
<b>Commodity:</b>	<b>Dairy, Butter ('000 MT)</b>					
	<b>2003</b>		<b>2004</b>		<b>2005</b>	
	Old	New	Old	New	Old	New
<b>Calendar Year Begin</b>	<b>01/2003</b>		<b>01/2004</b>		<b>01/2005</b>	
Beginning Stocks	248	248	276	276	200	232
Production	2,238	2,226	2,201	2,150	2,189	2,145
Extra EU25 Imports	98	92	103	90	101	90
<b>TOTAL SUPPLY</b>	<b>2,584</b>	<b>2,566</b>	<b>2,580</b>	<b>2,516</b>	<b>2,490</b>	<b>2,467</b>
Extra EU25 Exports	295	307	304	347	313	350
Domestic Consumption	2,013	1,983	2,076	1,937	2,027	1,937
Other Use, Losses	0	0	0	0	0	0
TOTAL Dom. Consumption	2,013	1,983	2,076	1,937	2,027	1,937
Ending Stocks	276	276	200	232	150	180
<b>TOTAL DISTRIBUTION</b>	<b>2,584</b>	<b>2,566</b>	<b>2,580</b>	<b>2,516</b>	<b>2,490</b>	<b>2,467</b>

Sources: FAS offices in EU MS, Eurostat, Global Trade Atlas

In **2005**, butter production is forecast to stagnate just below the 2004 level, despite the increase in milk deliveries. Imports are expected to remain stable, while exports are forecast to increase marginally, as world demand, for butter and more so butteroil, remains strong because of the lack of fresh supplies from Oceania. Domestic consumption is forecast to remain stable as European butter prices are expected to decrease, following the next cut in intervention prices in July of 2005. As a result, European intervention and Private Storage Aid (PSA) stocks, which are concentrated in Ireland and the Iberian Peninsula, are forecast to decrease to 180 thousand MT by the end of 2005, a reduction by more than 50 thousand MT.

However, the European dairy industry and the European Commission (EC) somewhat disagree on the butter market projections for 2005. The industry fears that the consumption balance between milk fat and milk proteins is shifting towards milk proteins because of the growing consumer preference for dairy products with lower fat contents. Arguably, at similar per capita consumption, this leads to a decrease in milkfat consumption, which results in a higher butter production. The industry thinks this could lead to a structural oversupply of butter. The EC, on the contrary, is confident that the 2005 limit of 60 thousand MT put on intervention purchasing at the prefixed intervention price, which already amounted to 18 thousand MT by the last week of April, will put enough downward pressure on butter prices to keep domestic consumption and exports in balance with supplies. Intervention buying beyond the 60 thousand MT limit could continue through purchase tenders at lower prices. In that case, butter ending stocks (intervention and PSA) for 2005 could end higher than this report forecasts. The reported lack of uncommitted butter supplies from Oceania until the next season is expected to enhance European butter exports as well. High world market prices for butteroil are also keeping processing of butter into butteroil and butteroil exports flowing.

Butter production in **2004** was 3 percent below the 2003 level, as a result of lower milk supplies. Important production decreases were recorded in the Benelux, Denmark, France and the United Kingdom; less so in Germany, where industrial cream imports from Lithuania, Poland and the Czech Republic prevented a larger decline in butter production. Imports were stable, while total EU exports of butter, mainly to the Middle East, and butteroil, to Mexico, increased by 13 percent as a result of lower competition from Oceania. Butter exports to Russia decreased by 40 percent, mainly because of problems with Polish dairy plant approvals and veterinary certificate problems. Domestic consumption declined by 2 percent, with sharp consumption decreases in the NMS as a result of important increases in butter prices after accession. Butter ending intervention and PSA stocks for 2004, benefiting from the increase in exports, were 44 thousand MT lower than at the end of 2003.

### Whole Milk Powder (WMP)

<b>Country:</b>	<b>EU-25</b>					
<b>Commodity:</b>	<b>Dairy, Whole Milk Powder ('000 MT)</b>					
	<b>2003</b>		<b>2004</b>		<b>2005</b>	
	Old	New	Old	New	Old	New
<b>Calendar Year Begin</b>	<b>01/2003</b>		<b>01/2004</b>		<b>01/2005</b>	
Beginning Stocks	0	0	0	0	0	0
Production	878	865	885	850	889	840
Extra EU25 Imports	4	5	1	3	1	3
<b>TOTAL SUPPLY</b>	<b>882</b>	<b>870</b>	<b>886</b>	<b>853</b>	<b>890</b>	<b>843</b>
Extra EU25 Exports	494	502	544	510	542	500
Domestic Consumption	388	368	342	343	348	343
Other Use, Losses	0	0	0	0	0	0
TOTAL Dom. Consumption	388	368	342	343	348	343
Ending Stocks	0	0	0	0	0	0
<b>TOTAL DISTRIBUTION</b>	<b>882</b>	<b>870</b>	<b>886</b>	<b>853</b>	<b>890</b>	<b>843</b>

Sources: FAS offices in EU MS, Eurostat, Global Trade Atlas

In **2005**, a further one percent decrease in WMP production is forecast to force exports down, despite continuing good market conditions. However, in light of increasing competition from Argentina and Oceania, European processors prefer to give advantage to the more profitable cheese production and export. This increase in competition is expected to hamper WMP exports to traditional markets in Africa, which are aggravated by stricter EC rules on proof of arrival before export refunds are paid. Especially, France expects to lose further market share in Algeria. WMP exports to the Middle East, especially to Iraq, are expected to remain firm. Domestic consumption is expected to remain stable in 2005.

In **2004**, WMP production already declined by 2 percent, compared to 2003, as a result of the decrease in milk deliveries and increased cheese production. WMP production decreased because of the decrease in milk supplies in the Benelux, the Czech republic, France and the UK. Increases occurred in Denmark, Germany, Poland and Slovakia, but these did not offset the decreases in the other MS. However, favorable export conditions led to an increase in exports, with Iraq becoming a major recipient, as dairy companies, mainly from the United Kingdom and the Benelux, cashed in on their commercial stocks. This is partly reflected in the decrease in the domestic consumption number. The surge in WMP exports, mainly to the Middle East, results from higher oil revenues in the Gulf states. French exports to Algeria



and other traditional markets in Africa decreased as a result of increased competition from Argentina.

### Non Fat Dried Milk (NFDM)

<b>Country:</b>	<b>EU-25</b>					
<b>Commodity:</b>	<b>Non Fat Dried Milk ('000 MT)</b>					
	<b>2003</b>		<b>2004</b>		<b>2005</b>	
	Old	New	Old	New	Old	New
<b>Calendar Year Begin</b>	<b>01/2003</b>		<b>01/2004</b>		<b>01/2005</b>	
Beginning Stocks	188	188	225	218	78	77
Production	1332	1326	1162	1090	1204	1100
Extra EU25 Imports	59	56	54	26	57	25
<b>TOTAL SUPPLY</b>	<b>1579</b>	<b>1570</b>	<b>1441</b>	<b>1334</b>	<b>1339</b>	<b>1202</b>
Extra EU25 Exports	336	339	352	285	320	280
Domestic Consumption	468	463	476	457	464	450
Other Use, Losses	550	550	535	515	545	472
TOTAL Dom. Consumption	1018	1013	1011	972	1009	922
Ending Stocks	225	218	78	77	10	0
<b>TOTAL DISTRIBUTION</b>	<b>1579</b>	<b>1570</b>	<b>1441</b>	<b>1334</b>	<b>1339</b>	<b>1202</b>

Sources: FAS offices in EU MS, Eurostat, Global Trade Atlas

NFDM production in **2005** is expected to stabilize at the 2004 level, with some recovery in production in France and Ireland offsetting further declines in the Benelux and Germany. The main reasons are the agreed reduction in intervention price for NFDM and the continuing strong demand for casein exports, which fuels casein production even with reduced aid levels. As a result, in spring 2005 so far, very little seasonal peak NFDM has been offered for intervention storage. NFDM imports are expected to be stable at best, while export levels are forecast to be sustained, as world demand remains firm, which results from low available NFDM supplies in Oceania and low stocks levels in the U.S. As a result, domestic NFDM consumption, especially for feed, is forecast to further decrease significantly, as intervention stocks of NFDM are likely to run out of product and human consumption will be privileged over feed consumption.

In **2004**, the decrease in milk deliveries, combined with increased cheese production in the EU, resulted in an 18 percent decrease in EU NFDM production compared to 2003. There were significant production decreases in the Benelux, Denmark, France, Germany, Ireland, Spain, United Kingdom, Hungary, Poland and Slovakia. The decrease in NFDM production was accentuated as France and Germany reported increases in casein production of more than 5 thousand MT each. NFDM imports also more than halved in 2004 compared to 2003, in particular a 42 thousand MT loss in imports from New Zealand was only partially offset by new imports from the United States. The significant deficit in production led to important decreases in exports. In particular exports from Poland and the Czech Republic were diverted to the EU internal market from markets in Algeria mainly. This also led to a decrease in domestic consumption, particularly for animal feed purposes. The sizeable decline in intervention stocks helped to supplement the NFDM deficit within the EU.

## Consequences of the CAP reform and possible implications from the Doha Development Agenda

### Milk production prospects

While a number of member states still oppose it, the 2003 CAP reform provides for three yearly 0.5 percent increases in milk production quota in the EU-15 starting in 2006. This agreement excludes the NMS as the deal was struck prior to accession. This was a compromise reached to satisfy member states that favored the abolition of milk quota altogether, with the expectation that dairy consumption would increase, mainly in the NMS. In light of this consumption increase, the oversupply situation was not expected to worsen as a result of these production increases. The industry currently thinks that dairy consumption is not increasing, because of the long-term decline in milk consumption in the EU-15. EU industry thinks that the EC is overly optimistic in its "Prospects for agricultural Markets in the EU" ([http://europa.eu.int/comm/agriculture/publi/caprep/prospects2004b/index\\_en.htm](http://europa.eu.int/comm/agriculture/publi/caprep/prospects2004b/index_en.htm)). However, while the industry would prefer to hold the milk quota increases off, they fear that the quota increases will not be reconsidered because of the political difficulties encountered to reach the 2003 reform compromise. This may be the more so, as the quota increases are only targeted at the EU-15 and 4 MS (Ireland, Italy, Spain and Greece) already obtained their quota increase in 2000, as part of the Agenda 2000 reform. Also, for Poland, the final quota needs to be set during 2005, because Poland obtained a temporary milk quota only in its accession agreement.

### Other possible developments resulting from CAP reform and the DOHA round negotiations

Several studies were executed by MS economic research centers and industry on the impacts of the latest CAP reform on the dairy sector in the MS, especially on farm income. A general conclusion is that the CAP reform will lead to a decrease in farm income and as such will drive milk producers to consolidate and probably also concentrate in lower milk production cost areas. The dairy industry is already anticipating on this with a consolidation between dairy cooperatives in Belgium, while a merger between Dutch Campina and Scandinavian Arla was ultimately canceled.

The key elements of the 2003 CAP reform taken into consideration are:

- production quotas will be maintained stable until 2014/2015, after three yearly 0.5 percent increases
- intervention prices for butter will decline by 25% in four years,
- intervention prices for non-fat dry milk will decline by 15% in three years,
- direct payments to dairy farmers proportional to their individual quotas were introduced in 2004 to partially compensate for price reduction, and will be completely decoupled by 2007, with several MS already having implemented decoupling at the beginning of 2005, with more to follow in 2006.

A study in the autumn of 2004 by the French dairy board Onilait, integrated assumptions about an EC commitment in the Doha trade negotiations to ban export restitutions in a linear way over a 10-year time period (see GAIN report [FR5007](#)). It concluded that for cheese and NFDM markets and processors would be able to adjust to exporting without export subsidies well before their elimination. Indeed, currently cheese exports to the United States already occur without export restitutions. For WMP, the study concludes that exports would gradually become uncompetitive and hence decrease. A doom scenario is really depicted for the future of the EU butter market. The study calculates that, considering the trend of decreasing milkfat consumption, the increase in milk supplies and a return to a long-term average butter

export situation of around 200 thousand MT per year (compared to our forecast of 350 thousand MT for 2005), structural butter surpluses could increase to 100 thousand MT per year by 2008. The study doesn't elaborate on a further butter scenario when the reduction in export restitutions supposedly would render butter exports uncompetitive.

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E34097	Favorable Market Conditions Draws EU NFDM Intervention Stocks Down	12/02/2004
E34092	Russia demands Harmonization of EU Certification for Exports	11/24/2004

##### France

Report Number	Title	Date
FR5007	Reportedly Butter Stocks at Dangerous Levels due to 2003 CAP Reform	05/11/2005

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